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No. 85-1877.

# In the Supreme Court of the United States.

OCTOBER TERM, 1985.

AZL RESOURCES, INC.,
PETITIONER,

*v.*

MARGARET HALL FOUNDATION, INC., ET AL.,
RESPONDENTS.

**Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.**

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## Question Presented.

Whether Section 20(a) of the Securities Exchange Act of 1934 precludes the assertion of liability, based on common law principles of apparent authority, against a corporation for the misrepresentations of an important corporate officer.

**List of Parties.**

The list of parties is as stated by the petitioner.

**Rule 28.1 List.**

Margaret Hall Foundation, Inc. and Lexington Cemetery Co., Inc. have no parent companies, subsidiaries or affiliates. The Plymouth-Home National Bank is a subsidiary of Conifer Group, Inc. The following companies are also subsidiaries of Conifer Group, Inc.: Bank of Cape Cod, Berkshire Bank & Trust Company, Essex Bank, Guaranty Bank & Trust Company, Conifer Computer Services, Inc. and Union National Bank.

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No. 85-1877.

# In the Supreme Court of the United States.

OCTOBER TERM, 1985.

AZL RESOURCES, INC.,
PETITIONER,

*v.*

MARGARET HALL FOUNDATION, INC., ET AL.,
RESPONDENTS.

## Brief in Opposition to Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit.

The respondents[1] respectfully request that the petition for a writ of certiorari to review the judgment and opinion of the

[1] The respondents, plaintiffs in six of twenty four actions consolidated in the District of Massachusetts by the Judicial Panel on Multidistrict Litigation under MDL Docket No. 584, are Margaret Hall Foundation, Inc., Lexington Cemetery Co., Inc., Harley Anderson Haynes, Ruth Mann Horowitz, Robert L. Horowitz as Trustee of the Alan J. Mann Trust, Susan P. Mann Trust and Gail A. Mann Trust, Walter B. Gates, George M. Berman and Alan R. Shoolman (as they comprise the Profit-Sharing Committee of the Unitrode Profit-Sharing Plan and Profit Sharing Trust Fund), and Martin B. Hoffman (as Trustee of Landlubber Deferred Profit Sharing Retirement Plan), individually and on behalf of ail others similarly situated; Benjamin Slomoff; Gerald J. Holton, Individually and as Employer and as Beneficiary of His Self-Employed

United States Court of Appeals for the First Circuit, entered in this proceeding on February 19, 1986, be denied.

## Opinions Below.

The opinions below are as stated by the petitioner.

## Jurisdiction.

AZL's statement of jurisdiction is correct, except insofar as it states that on May 13, 1985 "the District Court of Massachusetts certified the issue herein for review." Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit ("Pet.") 2. As set forth below in respondents' statement of the case, the question presented by AZL differs markedly from the issue addressed by the District of Massachusetts' February 15, 1985 order and from the issue decided by the Court of Appeals for the First Circuit.

## Statutes Involved.

*15 U.S.C. § 78j. Manipulative and deceptive devices*

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate com-

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Retirement Plan and Plymouth-Home National Bank as Trustee of a Self-Employed Retirement Plan, Gerald J. Holton FBO Gerald J. Holton; Bruno Rossi; James P. Giblin individually, and James P. Giblin as Trustee of the James P. Giblin Trust; and Michael Holt Massey. The six actions were the subject of the February 15, 1985 District of Massachusetts decision from which petitioner appealed to the Court of Appeals for the First Circuit, pursuant to 28 U.S.C. § 1292(b).

merce or of the mails or of any facility of any national securities exchange:

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

*15 U.S.C. § 77b. Definitions*

When used in this subchapter, unless the context otherwise requires:

. . . . . .

(2) The term "person" means an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organization, or government or political subdivision thereof. As used in this paragraph the term "trust" shall include only a trust where the interest or interests of the beneficiary or beneficiaries are evidenced by a security.

*15 U.S.C. § 78t. Liability of controlling persons*

(a) Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

## Statement of the Case.

Plaintiffs' amended complaints allege that Maurice Strong ("Strong"), the chairman of AZL Resources, Inc. ("AZL"), acting with at least the apparent authority of AZL, engaged in a scheme to disseminate materially false and/or misleading information involving AZL and an impending block purchase of AZL stock in order to manipulate the market price of AZL common stock by artificially inflating its price. Supplemental Appendix ("Supp. App."). The amended complaints followed an opinion dated July 31, 1984, in which the District Court of Massachusetts ("District Court") dismissed plaintiffs' claims against AZL because it found that the facts as alleged in the original complaints negated any inference that the actions of Strong and the other corporate officers and agents were performed for AZL's benefit, a necessary predicate for *respondeat superior* liability.[2] Appendix ("App.") B, 23a. Thereafter, on January 7, 1985, the District Court allowed plaintiffs' motions to amend to allege that Strong acted with "at least apparent authority" — a theory of liability which does not require a showing of benefit to AZL. App. C, 30a-31a.

AZL moved for reconsideration of the January 7, 1985 order, arguing in essence that the theory of liability asserted against AZL was based on *respondeat superior,* which, in AZL's view, had no applicability to securities fraud cases. App. D, 37a. In denying AZL's motion for reconsideration on February

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[2] As the plaintiffs have consistently argued below, the facts alleged by their complaints, and the inferences to be drawn therefrom, are adequate to support a finding that AZL stood to benefit from the misrepresentations of Maurice Strong and other AZL officers and directors, and from the subsequent artificial inflation of AZL's stock price. AZL stood to benefit from the higher stock price by obtaining an increased exchange ratio in any subsequent merger and by more readily obtaining capital, absent a merger, to fund its oil exploration activities.

15, 1985, the District Court held that the allegations of AZL's liability were legally sufficient based on a corporate principal's direct liability for the acts of its agents, not *respondeat superior*. App. D, 38a.

The District Court subsequently allowed AZL's request for certification of the issue determined by the District Court's February 15, 1985 order. App. E, 39a. In an opinion dated February 19, 1986, the First Circuit held that "section 20(a) [of the Securities Exchange Act of 1934] does not preclude the assertion of liability — based on common law notions of 'apparent authority' — against a corporation for the misrepresentations of an important corporate officer." App. A, 15a. It is this decision that petitioner now seeks to have this Court review.[3]

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[3] AZL framed the question presented here for review, Pet. I, in a manner which is at variance with the First Circuit's narrow holding that "section 20(a) does not preclude the assertion of liability — based on common law notions of 'apparent authority' — against a corporation for the misrepresentations of an important corporate officer." App. A, 15a. The First Circuit made no attempt to decide the general applicability of "principles of vicarious and strict liability" — a far broader question than the narrow issue of the applicability of agency-based liability premised on apparent authority addressed by the First Circuit. *Id.*

AZL's statement of the case, Pet. 3-4, also contains inaccuracies. Contrary to AZL's assertions, Pet. 4, the issue decided by the First Circuit does not "arise in the context of" a conflict between *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) and *American Society of Mechanical Engineers, Inc.* v. *Hydrolevel Corp.*, 456 U.S. 556 (1982). Although the First Circuit does advert briefly to the relationship between those two cases, App. A. 5a-6a, it is not a focal point of the decision, primarily because, as discussed at Part II.B., *infra*, there is no conflict or inherent inconsistency between *Hochfelder* and *Hydrolevel*. Further, as discussed at Part II.C., *infra*, there is no sharp conflict between the circuits as to the issue decided by the First Circuit.

## Summary of the Argument.

This case presents no extraordinary circumstances warranting interlocutory review by this Court, which has consistently refused to review cases concerning the applicability of common law agency principles to securities laws violations. In holding that Section 20(a) ("Section 20(a)") of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq. (the "1934 Act") does not preclude the imposition of liability upon AZL for the misrepresentations of its chairman acting with its apparent authority, the First Circuit decision comports with traditional agency law principles, the remedial purposes and legislative history of the 1934 Act, and the decisions of the clear majority of circuits which have considered the issue. The First Circuit's decision does not vitiate the scienter requirement of Section 10(b) of the 1934 Act ("Section 10(b)") because the scienter of AZL's chairman, acting with apparent authority, is imputed to AZL.

## Reasons for Denying the Writ.

### I. The Court's Exceptional Power to Review An Appeal From An Interlocutory Order Should Not Be Exercised In This Case.

Rule 17 of the Rules of the Supreme Court of the United States provides, *inter alia,* that:

> A review on writ of certiorari is not a matter of right, but of judicial discretion, and will be granted only when there are special and important reasons therefor.

Moreover, as to interlocutory matters, this Court has long applied an even more stringent standard for the grant of review, holding that "except in extraordinary cases, the writ is not issued until final decree," *Hamilton-Brown Shoe Co.* v. *Wolf Brothers & Co.*, 240 U.S. 251, 258 (1916), and that a writ of certiorari at an interlocutory stage of a case should not be issued unless extraordinary inconvenience and embarrassment in the conduct of a case will result from its denial. *American Constr. Co.* v. *Jacksonville, T.&K. W. Ry. Co.*, 148 U.S. 372, 384 (1893).[4]

No extraordinary circumstances are present here. First, AZL will not suffer, nor can it plead, extraordinary inconvenience by the denial of its petition. AZL is no different from any other interlocutory petitioner which must bear whatever inherent inconveniences litigation entails. Moreover, even if AZL were not a party, it would still be extensively and centrally involved in discovery and trial proceedings as plaintiffs pursue their claims against Strong and the five other individual AZL officers and directors. Thus, AZL's presence as a party, by itself, does not amount to "extraordinary inconvenience." *See American Constr. Co., supra,* at 384. Additionally, because the First Circuit's decision falls squarely within the clear majority of circuits, as discussed at Part II.C., *infra,* no embarrassment will occur by the denial of AZL's interlocutory petition. Finally, by allowing the case to proceed to a final disposition below, AZL will have the opportunity to prove at trial that Strong was not acting within his apparent authority or that the plaintiffs could not reasonably have relied on any such apparent author-

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[4] In *American Constr. Co.* the petitioner sought review of a nonfinal judgment, arguing, among other grounds, that because one of the judges who took part in the decision was forbidden by law to sit at the hearing, the disputed decree was wholly void. To delay appeal until a final judgment was rendered in that case was clearly an extraordinary waste of judicial and legal resources and this Court, finding that the case satisfied the extraordinary circumstances test, accordingly granted certiorari.

ity, thereby escaping liability under applicable agency principles, and rendering unnecessary any review by this Court of the issue presented by AZL.

## II. This Court Should Not Exercise Its Discretion to Grant AZL's Petition for a Writ of Certiorari Because AZL Has Failed to Present Any Special Or Important Reasons To Do So.

Since 1975 this Court has consistently declined to review cases concerning the applicability of common law agency principles to securities laws violations. *See, e.g., Sharp* v. *Coopers & Lybrand,* 649 F.2d 175 (3d Cir. 1981), *cert. denied,* 455 U.S. 938 (1982); *Henricksen* v. *Henricksen,* 640 F.2d 880 (7th Cir.), *cert. denied,* 454 U.S. 1097 (1981); *Marbury Management, Inc.* v. *Kohn,* 629 F.2d 705 (2d Cir.), *cert. denied,* 449 U.S. 1011 (1980); *Carpenter* v. *Harris, Upham & Co.,* 594 F.2d 388 (4th Cir.), *cert. denied,* 444 U.S. 868 (1979); *Zweig* v. *Hearst Corp.,* 521 F.2d 1129 (9th Cir.), *cert. denied,* 423 U.S. 1025 (1975). As demonstrated below, there is nothing in this case of such "peculiar gravity and general importance", *Hamilton-Brown Shoe Co., supra* at 258, to warrant this Court's departure from its prior practice.

### A. *The First Circuit Correctly Ruled that AZL is Liable for Its Agents' Misrepresentations Made with the Apparent Authority of AZL.*

The First Circuit's decision is well within the ambit of traditional agency law in holding that AZL is liable under the 1934 Act for the misrepresentations of its chairman. Recognizing the remedial purposes of the 1934 Act, the First Circuit reasoned:

> [A]s between the corporation that has placed the official in a position to invoke its authority (though improperly) and a victim, it seems fairer that the former bear the burden of an uncompensated loss. Further, imposing such liability will encourage corporate officials to prevent unauthorized (but 'apparently authorized') misrepresentations, thereby helping to achieve an important Securities [Exchange] Act purpose.

App. A, 8a-9a.

After concluding that imposition of vicarious liability upon a corporation for the "apparently authorized" misrepresentations of a high corporate officer is consistent with the policies and purposes of the 1934 Act, the First Circuit examined whether the inclusion of Section 20(a) was intended to preclude the imposition of vicarious liability. The First Circuit aligned itself with the majority of other circuits which have found nothing in the legislative history of Section 20(a) to indicate that it was intended to be the exclusive basis for imposing liability on one "who, directly or indirectly, controls any person liable." App. A, 9a-12a, *see also* Part II.C., *infra*. Instead, the First Circuit concluded that the legislative history of Section 20(a) "makes clear that the section was aimed at expanding liability, rather than contracting it," App. A, 9a, and stated that "by explicitly including corporations in its definition of 'person', 15 U.S.C. § 77(b)(2), the statute seems to foresee that corporations will be held liable." App. A, 12a.

Because, as the First Circuit recognized, corporations can act only through their agents, this liability can only be imposed through principles of vicarious liability. Further, the facts and theories of this case place it "in the heartland of traditional agency law." App. A, 15a. Thus, it would do violence to the

statutory framework to hold that principles of vicarious liability do not apply and Section 20(a) is the exclusive basis for imposing secondary liability under the 1934 Act.

The First Circuit's decision below is fully consistent with this Court's holding in *American Society of Mechanical Engineers, Inc.* v. *Hydrolevel Corp.*, 456 U.S. 556, 570 (1982), a case arising under the Sherman Act, 15 U.S.C. §§ 1 et seq., that "a principal is liable for an agent's fraud though the agent acts solely to benefit himself, if the agent acts with apparent authority." *Id.* at 566. This Court recognized that the "apparent authority theory has long been the settled rule in the federal system" and that liability has been imposed upon principals based upon this theory in "a wide variety of areas." *Id.* at 567-568. In so holding this Court cited with approval two federal securities laws cases which adhere to the majority view that common law agency principles are available to impose liability for violation of the securities laws. *See Holloway* v. *Howerdd*, 536 F.2d 690 (6th Cir. 1976); *Kerbs* v. *Fall River Industries, Inc.*, 502 F.2d 731 (10th Cir. 1974).

### B. *The Scienter Requirement of Section 10(b) is Not Vitiated by the First Circuit's Holding.*

Faced with this Court's affirmation of the vitality of the common law agency principle of apparent authority in *Hydrolevel*, AZL incorrectly contends that imposition of liability based on apparent authority in this case would be inconsistent with this Court's decision in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976) (holding that scienter is a necessary element of violations of Section 10(b) as implemented by Rule 10b-5). Pet. 4. The First Circuit recognizes *Hochfelder*'s scienter requirement, but correctly observes that the scienter requirement — with respect to a corporation which employs those who

knowingly or recklessly make misrepresentations — can be satisfied by the scienter of the agent. App. A, 5a-6a.

This Court has recognized that it is "elementary" that "impersonal entities can be guilty of 'knowing' or 'willful' violations of regulatory statutes through the doctrine of *respondeat superior*." *United States* v. *A & P Trucking Co.*, 358 U.S. 121, 125 (1958). The application of agency principles does not undermine the elements of liability necessary to establish a violation, but instead serves to identify those who may be held vicariously liable for that violation. The scienter requirement of Section 10(b) is satisfied by the state of mind or conduct of the agent, which may then, on appropriate facts, be imputed to the corporation. Here, Strong's willful and knowing violations of the 1934 Act must be imputed to AZL which cloaked Strong, its chairman, with at least apparent authority.

### C. *Contrary to AZL's Assertions, No Sharp Conflict Exists Between the Circuits.*

In Argument V. of its Petition (Pet. 18-21), AZL asserts the existence of a "sharp conflict" between the circuits as to the applicability of common law agency principles to impose liability upon a principal for the securities fraud of its agent. AZL's assertion is inaccurate. By its decision below, the First Circuit became the tenth circuit to address, and the seventh to affirm, the applicability of common law agency principles to violations of the securities laws. It joined the clear majority of six other circuits — the Second,[5]

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[5] *Marbury Management, Inc.* v. *Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied* 449 U.S. 1011 (1980); *SEC* v. *Management Dynamics, Inc.*, 515 F.2d 801, 812-813 (2d Cir. 1975).

Fourth,[6] Fifth,[7] Sixth,[8] Seventh[9] and Tenth[10] Circuits — which have expressly found those agency principles applicable. Only three[11] of the ten circuits appear to take a contrary view — the Third, Eighth and Ninth — and, as the First Circuit noted with respect to the Ninth and Third Circuits, the persuasive force of the opinions of those circuits is limited by the fact that those cases involved factual circumstances wherein traditional agency principles prohibit or caution against liability. App. A, 13a. Accordingly, there is no sharp conflict between the circuits which would warrant this Court's review.

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[6] *Carras* v. *Burns*, 516 F.2d 251, 259, 261 (4th Cir. 1975); *Johns Hopkins University* v. *Hutton*, 422 F.2d 1124, 1130 (4th Cir. 1970), *cert. denied*, 416 U.S. 916 (1974).

[7] *Paul F. Newton & Co.* v. *Texas Commerce Bank*, 630 F.2d 1111, 1118-1119 (5th Cir. 1980); *Lewis* v. *Walston & Co., Inc.*, 487 F.2d 617, 623 (5th Cir. 1973).

[8] *Holloway* v. *Howerdd*, 536 F.2d 690, 694-695 (6th Cir. 1976); *Armstrong, Jones & Co.* v. *SEC*, 421 F.2d 359, 362 (6th Cir.), *cert. denied*, 398 U.S. 958 (1970).

[9] *Fey* v. *Walston & Co., Inc.*, 493 F.2d 1036 (7th Cir. 1974); *Carroll* v. *First National Bank of Lincolnwood*, 413 F.2d 353, 358 (7th Cir. 1969), *cert. denied*, 396 U.S. 1003 (1970).

[10] *Kerbs* v. *Fall River Industries, Inc.*, 502 F.2d 731 (10th Cir. 1974).

[11] *See, e.g., Sharp* v. *Coopers & Lybrand*, 649 F.2d 175, 180-184 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982); *Rochez Bros.* v. *Rhoades*, 527 F.2d 880 (3d Cir. 1975); *Thomas* v. *Duralite Co., Inc.*, 524 F.2d 577 (3d Cir. 1975); *Myzel* v. *Fields*, 386 F.2d 718, 738 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Christoffel* v. *E.F. Hutton & Co.*, 588 F.2d 665 (9th Cir. 1978); *Zweig* v. *Hearst Corporation*, 521 F.2d 1129, 1132-1133 (9th Cir.), *cert. denied*, 423 U.S. 1025 (1975); *Kamen & Co.* v. *Paul Aschkar & Co.*, 382 F.2d 689 (9th Cir. 1967), *cert. granted*, 390 U.S. 942, *cert. dismissed*, 393 U.S. 801 (1968).

**Conclusion.**

For these reasons, a writ of certiorari should not issue to review the judgment and opinion of the United States Court of Appeals for the First Circuit.

Respectfully submitted,

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**Supplemental Appendix.**

| | | |
|---|---|---|
| IN RE: | ) | |
| ATLANTIC FINANCIAL | ) | |
| MANAGEMENT, INC. | ) | MDL DOCKET NO. 584 |
| SECURITIES LITIGATION | ) | |
| | ) | |
| MARGARET HALL | ) | |
| FOUNDATION, INC., ET AL, | ) | |
| Plaintiffs | ) | CIVIL ACTION NO. |
| | ) | 83-405-S |
| V. | ) | |
| MAURICE STRONG, ET AL, | ) | |
| Defendants | ) | |
| | ) | |

PLAINTIFFS' AMENDMENT TO THEIR COMPLAINT PURSUANT TO RULES 15 and 59 OF THE FEDERAL RULES OF CIVIL PROCEDURE

Plaintiffs hereby amend their Complaint by repeating and realleging each and every allegation of Paragraphs 1-117, inclusive, and by adding:

(1) as Paragraphs 30a and 30b, to be inserted immediately after Paragraph 30 and immediately preceding Paragraph 31, the following:

30a. During the period commencing at least as early as April 1981 through at least March 1982, AZL was actively seeking infusions of additional capital to finance the exploitation and development of oil and

gas properties in which it held an interest. The scheme and plan was calculated to assist AZL to obtain the level of capital it needed because, by increasing the market price of AZL stock, AZL (i) increased its ability to obtain a favorable exchange ratio in any stock-for-stock merger or acquisition through which AZL would acquire a company possessing the requisite capital and/or (ii) increased the amount of capital which AZL could raise directly by selling or pledging its stock.

30b. In disseminating the materially false and/or misleading information referred to in paragraph 30 Strong acted with at least the apparent authority of AZL.

Plaintiffs by their attorney,

/s/

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